

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)	
)	
Implementation of Section 304 of the)	
Telecommunications Act of 1996)	CS Docket No. 97-80
)	
Commercial Availability of)	
Navigation Devices)	

Consumer Electronics Retailers Coalition
Reply To The NCTA Letter As To "Retail Set-Top Initiative"
And To The NCTA Response To
CERC Status Report
"J2K Plus 1"

November 6, 2001

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This filing is respectfully made by the Consumer Electronics Retailers Coalition ("CERC"), in response to filings made in this Docket by the National Cable and Telecommunications Association ("NCTA").

On October 10, the NCTA filed with Chairman Powell an *ex parte* letter outlining a "retail set-top initiative," said to be for the benefit of consumer electronics retailers and their customers.¹ CERC and its members were not consulted in advance by the NCTA or its members with respect to its initiative.²

¹ See Letter from Robert Sachs, President & CEO, NCTA, to the Honorable Michael K. Powell, Chairman, Federal Communications Commission (October 10, 2001)("NCTA Letter").

² Various Chief Executive Officers of retailers were notified by an October 10th letter of the NCTA's unilateral initiative. The letter did not solicit comment from the retailers.

Several weeks earlier, on September 21, the NCTA filed a "response" to a CERC *ex parte* filing made in this Docket on July 16.³ In that filing, CERC noted that the Cable Industry's obligation to file twice-yearly status reports as to its progress in supporting market entry under existing FCC regulations had expired, and so was submitting its own Status Report. The CERC filing was pursuant to the Commission's "Year 2000 Review," which was initiated in September, 2000.

CERC's membership is broadly representative of the retailers anxious to sell competitive navigation device products. The manufacturers whose products are sold by CERC members have been responsible for the competition that has continually brought new features and value to display, storage, computing, communications, imaging, and printing products, and to most other products associated with the Internet revolution. Yet they have not been allowed to bring their competitiveness and ingenuity to the world's biggest broadband system -- now in its sixth decade of monopolization by cable service distributors. Instead, they have been forced to line up for secondary procurements, for non-portable proprietary devices, by MSOs who have remained in firm control of proprietary, segmented, and stagnating device markets. The NCTA's unilaterally pronounced "retail set-top initiative" promises to freeze this mold for the foreseeable future, rather than to break it.

³ Response of the National Cable Television Association to CERC *Ex Parte* Submission, CS Docket No. 97-80 (filed Sept. 21, 2001) ("NCTA Response").

I. The NCTA's Opposition to CERC's Proposals and The NCTA's Own Initiative Reveal the Industry's Motivation to Retain its Anticompetitive "Gatekeeper" Status in the Information Age.

None of the NCTA's recent actions and filings demonstrates real concern about enabling true competitive entry. Nor is there any evidence of a single, responsible commitment to achieve it. While the NCTA continues to argue without merit that retailers, under the CERC proposals, seek only a new "revenue stream" from cable, it is of course clear that the cable industry's interest in controlling the distribution of set-top boxes does not stem from an interest in set-top box equipment revenues. Rather, in the new digital world, the cable industry is fearful that by losing control of the set top box, it will simultaneously lose monopoly control of new service revenues stemming from the increasing amount of information that travels in and out of these devices.⁴ Increasingly, the set top box will serve as a multifunction entertainment and communication device providing Internet access, home networking and other features. Control of the box will facilitate the cable company's leveraging of its existing position in program distribution into other markets like Internet access, media streaming, interactive services and networking that should be highly competitive.⁵

The ability of the cable industry to 1) control input to and output from navigation devices, 2) subsidize the cost of its new digital boxes using revenue from the older analog boxes (and analog subscribers) and certain service revenues, and 3) limit the sale of the box at retail, as the NCTA currently proposes, enables the industry to both control the distribution of boxes and, more importantly, to tighten its control of new services provided through or using the set top

⁴ See, e.g., Lisa Bennet-Haigney, *Will the Media Merger Free-For-All Extinguish Women's Voices?*, National NOW Times, Fall 2001, at 16.

⁵ See, e.g., ICTV, Inc. ICTV supplies cable companies with "walled gardens," "tightly controlled" and closed broadband communications systems enabling cable-controlled set-top boxes to provide interactive television. ICTV happens to be financed in large part by the cable industry and Motorola and Scientific-Atlanta. See attached ICTV White Paper.

box.⁶ Section 629 of the Communications Act was created to assure the competitive availability of navigation devices. It is unfortunate that the cable industry's discriminate implementation of the Act's provision on equipment aggregation has channeled the transition to the digital age into yet another instrument for retention of monopolistic control over revenue from the growing number of new, non-cable services available to consumers.⁷

While a battle continues to brew with regard to control over services, the retailers' perspective with regard to the sale of navigation devices has not changed in six years. The consumer electronics retail industry continues to seek effectuation of Section 629 of the Act, so that it may offer consumers the opportunity to select and own a broad range of innovative navigation device products at competitive prices. It is with this purpose in mind that the retail industry urges the Commission to adopt CERC's proposals.

CERC's main objective is to focus the cable industry and the Commission on two remaining "showstoppers" preventing the development of a competitive market for navigation devices -- pivotal problems which, unless solved, would continue to foil competitive entry.

These are:

(1) no acceptance by cable operators of any obligation or responsibility to support at their headends the operation of the competitive devices that enjoy the "right to attach" under Commission regulations, and

⁶ See *The Bigger Picture: Why the Possible Sale of AT&T Broadband Spooks 'Content' Firms*, Wall Street Journal, August 27, 2001 at A1. The Chairman and Chief Executive Officer of Scientific-Atlanta, one of the two largest manufacturers of cable boxes recently exposed the cable industry's true business model: "It's not about thick clients or thin clients or expensive or inexpensive set-tops. It's really about services the cable operator intends to offer over the next five years." *The Competitive Challenge*, Advertising Supplement to Multichannel News, October 29, 2001, 11A. The NCTA's recent "retail" proposal also allows the industry to channel its capital into maintaining control of access to consumers, rather than into supporting competitive access devices, as the 1996 law intended.

⁷ See, e.g., Liberate PopTV Program, (visited October 1, 2001). [Http://www.liberate.com](http://www.liberate.com). Liberate, through its PopTV program, distributes interactive services. Cable companies, Motorola and Scientific-Atlanta are among Liberate's primary investors and partners.

(2) discriminatory administration by the cable industry of a subsidy, so as to penalize those consumers who would choose to attach a competitive product rather than a leased product.

CERC had hoped that the NCTA could or would provide some evidence, in its September response, of industry recognition of these issues, and make a clear, testable commitment to address them through private sector activity. Unfortunately, no such assurance or commitment was forthcoming. Instead, the NCTA has offered an initiative of its own that provides strong evidence that the cable industry is not only uninterested in achieving a competitive market for set-top boxes and other devices, but is also attempting through its proposal to tighten and extend its control of the markets for both devices and information.

As presented by the NCTA in these two filings, the industry seeks confrontation but avoids commitment – in the hope that the Commission will do nothing to enforce or strengthen its regulations, and instead will give it free reign to ignore the 1996 law. The core industry position, as presented in the September 21st filing, is a series of responses that add up to a refusal to accept any responsibility for the success of the initiatives *for which the industry itself volunteered* in 1997 and 1998. It is now time for the Commission to strengthen its regulations, so as to ensure that its statutory obligation is met.⁸ FCC adoption of the amendments to the regulations in this Docket, as endorsed by CERC in its July 16 Status Report, is the key to meeting this goal.

⁸ These initiatives were offered to, and accepted by, the FCC in lieu of direct standard-setting or other regulatory action by the Commission. See In the Matter of Implementation of Section 304 of the Telecommunications Act of 1996; Commercial Availability of Navigation Devices, CS Docket No. 97-80, Report & Order, 13 FCC Rcd 14775, ¶ 8, 14 (Rel. June 24, 1998) (“Navigation Device Order”) and Further Notice of Proposed Rulemaking, 15 FCC Rcd 18199, ¶ 6 (Rel. Sept. 18, 2000) (“Navigation Device FNPRM”).

II. The NCTA "Retail Set-Top Initiative" is Disappointing To Manufacturers, Retailers and Consumers, And Is Not A Substitute For Compliance With Statutory Obligations And FCC Regulations.

CERC hopes that the NCTA "initiative" presages a recognition by cable operators of the advantages and competitive potential of retail distribution. However, as a purported substitute for meeting cable industry obligations under the 1996 Telecommunications Act and the 1998 Report and Order of the FCC in CS Docket 97-80, the measures discussed are unnecessary, severely inadequate, and disappointing for consumers, retailers, and independent manufacturers.

Based on the description provided in the NCTA press release and its letter to Chairman Powell, the plan is burdensome and confusing for both consumers and retailers. The following points summarize several of CERC's concerns with the NCTA's proposal:

- Cable operators would only "encourage" their present vendors (predominantly Motorola and Scientific-Atlanta) to deal directly with retailers as to system-specific set-top boxes. No assurance is made, however, that the cable operators themselves will treat the competitive retail customers equally with their lease customers by supporting the retail boxes at their headends.
- The cable operators, according to NCTA, appear jointly to have agreed on an artificially low "cap" on the price they would offer to consumers to "buy back" these non-portable set-top boxes in the event the consumer moves. They have agreed to cap this price at the operator's depreciated **wholesale** cost -- yet they would remain free to redistribute the same box to their lease customers, at full retail price.
- By jointly agreeing to cap "buyback" prices at levels according to their tax depreciation schedules, the cable operators seem to assure that the buy-back price offered to consumers would be inadequate and disappointing. This approach would also make it extraordinarily difficult for a retailer to explain this policy to customers, or to give them any assurance that they would be treated fairly. (Ironically, the NCTA has criticized the pending simpler and more neutral Consumer Electronics Retailer Coalition proposal to amend Commission regulations to assure for equal treatment of lease and sale customers as confusing to explain or implement.⁹)
- According to the NCTA letter, cable operators apparently have agreed jointly to refrain from providing relief for sales customers when a cable multi-system operator ("MSO") *moves away from the customer*. This happens quite often. Sales or "swaps" of local cable

⁹ See discussion at pages 18-22.

franchises have always followed sales or mergers of major cable systems. At present, the largest cable system -- AT&T Broadband -- is for sale. Major reallocations of cable customers inevitably will follow.

- The letter to the FCC seems intended to undercut enforcement and strengthening of FCC regulations aimed at assuring true national portability of devices. Cable systems continue to refrain from *any public commitment* toward this end. Whereas, in the FCC letter, the leased-box-at-retail program is undertaken as an MSO "commitment," the support of truly portable and competitive standards is styled only as a "priority" of the industry CableLabs research consortium -- not of the industry itself, or of any cable system operator.
- Most grievously in the long run, by putting its focus back on separate, system-specific, proprietary set-top boxes, this NCTA initiative represents a sharp movement **away** from long-term competition. The NCTA initiative would lock consumers into a choice of only a few products, selected for them by the cable industry. The real benefit of telephone deregulation was the freedom to include telephone functions in an array of new multi-function devices such as PCs, fax machines, local networks, business networks, DBS receivers, etc. that would never have been provided by a single company focused on telephone communications. By jointly declaring that consumers should be happy with separate set-top boxes, tied to diverse and divergent local systems, the cable industry attempts to forestall the most dynamic sort of competitive entry -- the dynamic kind that the sponsors of the "competitive availability" provision of the 1996 Telecommunications Act explicitly meant to assure.

A. In Its "Response" To The CERC Status Report the NCTA Continues To Avoid Acceptance Of Any Responsibility For Supporting The Operation On Cable Networks of Attached Devices.

The NCTA "response" is simply an elaboration, in a new context, on the theme it has sounded since the passage without result of the July 1, 2000 deadline for support of competitive availability. The NCTA attitude continues to be: cable industry members had an obligation only to supply "PODs," not to assure that devices designed to CableLabs specifications would actually be supported on MSO systems. In fact, no entity in the cable industry ever assumed or has offered to assume responsibility for such functionality. Thus, despite claims that the deadline was "met," the potential competitive entrants were left hanging in July 2000:

(1) the specification was not available in time to support manufacture of products by competitive entrants by July 1, 2000;¹⁰

(2) when available, the specification was for a product far inferior to those already available for lease by MSOs; and ¹¹

(3) insufficient testing had been performed to assure that a competitive product would have worked with the PODs supplied by the cable industry.¹²

The NCTA does not contravene any of these facts -- it only disclaims responsibility for them. In its September response, the NCTA continues to disclaim responsibility for these failures by stating that MSOs have "an incentive" to support the Open Cable Access Platform ("OCAP") specification but avoiding any promise or acknowledgement of any obligation to do so.¹³ In addition, the NCTA, in both its September filing and October letter, indicates once again that the industry might address the portability issue. However, actions speak louder than words. Instead of relying on portability to help achieve a truly competitive marketplace, the NCTA's "retail initiative" reflects a core desire to perpetuate the regime of non-portable, proprietary navigation devices. The proposal as presented, of course, would not lead to a new competitive navigation device market, but rather to a new distribution stream for the cable industry and its dedicated manufacturers.¹⁴

¹⁰ See Comments of the Consumer Electronics Association in the FNPRM Proceeding, CS Docket 97-80 (filed Nov. 15, 2000) at 8-16 ("CEA Comments").

¹¹ Petition for Reconsideration of Time Warner Cable *In the Matter of Compatibility Between Cable Systems and Consumer Electronics Equipment*, PP Docket No. 00-67 (filed Nov. 27, 2000) ("Time Warner Petition").

¹² See generally CEA Comments; Reply Comments of Consumer Electronics Association in the FNPRM Proceeding, CS Docket 97-80 (filed Dec. 18, 2000) ("CEA Reply Comments").

¹³ NCTA response at 2, 11-13. See attached summary explanation of the OCAP specification released on CableLab's website.

¹⁴ *Id.* at 2, 13-17. The NCTA also spends considerable time attempting to compare the retail potential of its proposal to the competitive sales of cable modems. It is essential to distinguish the two by pointing out that the cable industry has never had control over the market for IP protocol broadband services. The retail of navigation devices is more equivalent to the retail entry of telephone customer premises equipment upon the Commission's order to unbundle telephone CPE equipment and services.

In its Response, the NCTA continually relies on purported efforts made by one of the industry's primary manufacturers – Motorola – to sell at retail.¹⁵ The prototype products referred to in fact represent another movement away from portability, competition, and design innovation, and toward the capture of additional existing and presently competitive retail markets by proprietary, MSO-centric distribution. The prototype touted by NCTA adds consumer electronics home theater and IT interactivity features to navigation functions, but it reflects not the slightest bow toward POD reliance, portability, or other retail attributes. Retailers would be expected to explain to any consumer considering the purchase of one of these \$800 devices that the cable navigation features would lose some or all value in the event of a change in cable system, and then to explain the capped and complicated "buyback" scenario.¹⁶

While CERC cannot speak for its members in a commercial context, in a regulatory context such initiatives appear to represent either an attempt to persuade the FCC of a non-existent commitment, or, even worse, an intention to swallow up additional, presently competitive, consumer product functions into products whose only true utility lies in captive, proprietary, MSO distribution. It is hardly surprising, therefore, that in putting forth its "retail initiative," the NCTA quotes executives of Motorola and Scientific-Atlanta, the predominant

¹⁵ *Id.* at 6-7, 21. Two manufacturers – Motorola and Scientific-Atlanta – dominate the manufacture of the cable industry's set-top boxes. Dorothy Pomerantz, *A Cozy Duopoly*, *Forbes*, March 19, 2000 at 78.

¹⁶ NCTA has not spelled out how MSOs have agreed to handle pricing as to, or have agreed to permit, the buyback of such a product.

manufacturers of the cable industry's proprietary boxes, as supportive.¹⁷ These two manufacturers will now seek to corner the retail market in addition to their lease market.

Finally, and perhaps most egregious, is the cable industry's request that the Commission either eliminate the integrated security phase-out that created the "POD" solution, or refrain from accelerating the date when cable operations must rely upon the same separate security offered to independent manufacturers.¹⁸ The separate security "POD" feature is not a hindrance to the competitive availability of navigation devices.¹⁹ Repealing the restriction on integrated devices would eliminate one of the few advances made in the implementation of the statute and would be a significant step backward in creating an innovative and diverse selection of products. The carefully couched nature of the representations and non-commitments made on behalf of the cable industry cannot be lost on those who would have to invest manufacturing and distribution resources, and customer good will, in reliance on such statements.

¹⁷ See *Cable Industry Announces Retail Set-Top Initiative*, NCTA Press Release, <http://www.ncta.com/press/press.cfm?Prid=188&showArticles=ok>, Oct. 10, 2001. Interestingly, in an interview where Jim McDonald, Chairman and CEO of Scientific-Atlanta "isn't shy about what he thinks," Mr. McDonald responds to a question regarding the viability of the retail market for set-top boxes by stating: "[r]etail isn't a big issue one way or another...[T]here isn't an economic model for retail...[w]hy would a [cable 'guy'] go retail and pay the expense if he doesn't need to? . . . You don't." In the article, it is clear that Mr. McDonald doesn't even contemplate an independent retail model for set-top boxes. Scientific-Atlanta's ties to the cable industry are clear. *The Competitive Challenge*, Advertising Supplement to Multichannel News, October 29, 2001, 11A-12A.

¹⁸ NCTA Response at 18.

¹⁹ CERC addressed this issue at length in its initial and reply filings in the ongoing Year 2000 Review. Comments of CERC in the Navigation Device FNPRM, CS Docket 97-80 (filed Nov. 15, 2000)("CERC Comments"); Reply Comments of CERC in the Navigation Device FNPRM, CS Docket 97-80 (filed Dec. 18, 2000)("CERC Reply Comments").

B. The NCTA's "Initiative" And Response to CERC Needlessly Distract Attention from the Steps Needed to Ensure a Competitive Market.

The NCTA states in its Response that the industry has the incentive to complete the specifications on portability.²⁰ Yet, rather than complete the specification and rely on it themselves, the industry has taken significant steps to present an "initiative" to the Commission that provides an elaborate, complicated and confusing "buy back" scheme to somehow enable consumers to sell back their non-portable box (at wholesale) to cable companies when they decide to move. Whether MSO prices are set jointly or individually, a buy back scheme is not a substitute for the development of a competitive market for navigation devices. CERC continues to propose simply that the Commission require CableLabs to complete the OCAP specification by a date certain and require cable companies to rely on those specifications themselves and support them by a date certain (now, January 2003). If the industry has an "incentive," as the NCTA indicates, to rely on and support the OCAP portability specification, there should be no reason for the industry to 1) protest a requirement that it indeed complete the specification, rely on it and support it, and 2) propose its own complicated scheme that circumvents the very portability OCAP is intended to achieve.²¹ NCTA says "that none of the MSO statements cited by CERC provides any evidence that cable operators are not committed to support the development and implementation of OCAP, or that they are pursuing proprietary middleware solutions to the exclusion of OCAP."²² While CERC disagrees, it is more to the point that, faced

²⁰ In response to CERC's assertion that the industry makes no obligation to produce or support OCAP middleware specifications, the NCTA simply states that the lack of such obligation is not "grounds for claiming that the industry is not committed to supporting this initiative voluntarily." NCTA Response at 11.

²¹ Indeed, it is odd that the NCTA says "that none of the MSO statements cited by CERC provides any evidence that cable operators are not committed to support the development and implementation of OCAP, or that they are pursuing proprietary middleware solutions to the exclusion of OCAP." NCTA Response at 13 (emphasis removed). If, in fact, the industry supports and intends to use the OCAP specifications than why does the industry object to a requirement that they do so and why would it propose its current initiative?

²² NCTA Response at 13 (emphasis removed).

with CERC's allegation, none of NCTA's filings provides a ray of hope or a scintilla of evidence that MSOs are committed to implementing OCAP, or that they are not committed to maintaining primary reliance on proprietary solutions. Moreover, if the industry members do support and intend to use the OCAP specifications, the industry should not object to a requirement that it do so by a date certain. Such a requirement would provide the evidence -- so sorely needed by consumer electronics and IT manufacturers -- of industry support that would justify investment in expensive OCAP-reliant products such as DTV receivers, that would finally break the DTV transition logjam.

The recent actions of the NCTA provide ample evidence of the industry's continued interest in redefining the statute's intent to its own advantage. When Congress required the competitive availability of navigation devices, it intended that retailers and manufacturers provide consumers with a wide range of products not selected by the cable industry. As the NCTA's response and October 10th letter make clear, the industry will not give up its control and domination of device design, distribution and development without further Commission intervention.

III. CERC Again Urges the Commission to Neutralize the Application of the Cable Industry's Equipment Subsidy.

In its Further Notice of Proposed Rulemaking issued last year, the Commission voiced both interest and concern in understanding what barriers, in addition to the technical barriers outlined above, hamper the development of a competitive market for navigation devices.²³ CERC demonstrated that the subsidy provided by many MSOs to their digital subscribers creates a serious barrier to entry by competitive retailers of navigation devices. It also precludes the development of a wide range of new consumer electronics products that incorporate the

²³ Navigation Device FNPRM ¶ 12-13.

navigation device as one feature of a multifunction product. CERC presented a solution to the subsidy problem that permits MSOs to continue subsidizing digital set top boxes if they choose, but bars them from discriminating against their digital subscribers who obtain a navigation device from a competitive source.²⁴

NCTA states in its September response that the concerns and solutions raised by CERC are unnecessary, burdensome and conflict with the express terms of the Communications Act provisions on equipment averaging.²⁵ In this Reply, CERC demonstrates how the Commission can resolve the purported conflict between the competitive availability of navigation devices (Section 629 of the Act) and the equipment averaging provisions of the Act (Section 623 of the Act). CERC has proposed solutions that are not unduly burdensome and that are in fact consistent with the intent of both statutory provisions.

The cable industry maintains that the lease of set top boxes is not its primary business interest and that its principal focus is on the provision of services. If this is true, CERC encourages the Commission to consider why the NCTA continues to oppose the steps necessary to facilitate the development of a competitive market for navigation devices.

In addressing the economic barriers to a competitive market, CERC has proposed several possible solutions. In its two most recent filings, the NCTA once again shows its reluctance to

²⁴ CERC Status Report, "J2K Plus One," CS Docket No. 97-80 (filed Jul. 16, 2001)("CERC Report"); Letter from Leonard H. Roberts, Chairman and CEO, RadioShack Corporation, and W. Alan McCullough, President and CEO, Circuit City Stores, Inc. to the Honorable Michael K. Powell, Chairman, Federal Communications Commission (April 16, 2001)("RS/CC Letter to Powell").

²⁵ NCTA Response at 26.

amend practices that clearly create economic barriers to competition. The “retail” solution presented in the NCTA’s October 10, 2001 letter to Chairman Powell is no solution at all. What the NCTA proposes is a retail market for its own proprietary equipment. That approach does not provide consumers with an economically competitive market for navigation devices and would certainly preclude the development of a wide range of consumer products incorporating the navigation device as one of several useful features. The NCTA solution would require that:

- manufacturers develop system-specific versions of every multifunction product to be sold at retail;
- retailers in multi-MSO markets ensure that the right product gets to the right consumer, and
- every consumer electronic device employing navigation features be included in a buy back program.

It is inconceivable that the NCTA buy-back approach would support the development of a wide array of multi-function devices from different manufacturers. Contrary to the Act, the NCTA proposal would enhance the cable operators’ proprietary status by providing only a handful of products and the limited option to either buy the cable operator’s set-top box or to lease the same cable operator’s set-top box.

NCTA states that its proposal “represents a major advance toward meeting the goals of Section 629 of the Communications Act – the ‘commercial availability’ provision.”²⁶ In fact, this section is entitled the “Competitive Availability of Navigation Devices.”²⁷ The intent of Congress was not merely to make the box commercially available at retail, but to ensure the development of a competitive marketplace.

²⁶ NCTA letter at 3.

²⁷ 47 USC § 549 (emphasis added).

A. The Legislative History of the Equipment Averaging and the Competitive Availability of Navigation Devices Provisions Supports CERC's Proposal.

NCTA has emphasized that the enactment of the current equipment averaging provision in the 1996 Telecommunications Act at the same time as the competitive availability provision is evidence that the subsidies the cable industry utilizes are both justified and permissible.²⁸ To the contrary, however, while certain subsidies may be permissible under Section 623 of the Act, such subsidies were not intended to undermine the purpose of another statutorily mandated requirement – i.e., the competitive availability of navigation devices. It is precisely because Congress enacted these two provisions simultaneously that the Commission must infer Congress' intent that both provisions be fully effectuated.

While Congress granted the cable industry additional latitude in the use of equipment averaging in 1996, Congress also indicated that equipment averaging is just one way of accomplishing the deployment of digital technology.²⁹ By enacting an entirely separate provision to assure the competitive availability of navigation devices Congress clearly intended that multiple methods, co-existing and not conflicting, be utilized to provide consumers with a broader choice of digital products at competitive prices. CERC continues to believe, as it has stated in earlier pleadings, that the FCC should condition the industry's use of equipment averaging methods upon elimination of the current discrimination against retail purchasers.³⁰

In establishing statutory parity it is important to recognize the limited purpose of the equipment averaging provisions in the 1996 act. As the NCTA indicates in its response, Congress stated that the equipment averaging provisions were enacted in the 1996 Act to “reduce

²⁸ NCTA Response at 26-27.

²⁹ H.R. Rep. No. 104-204 at 108 (1995).

³⁰ See, e.g., CERC Comments at 25-31; CERC Report at 14-16.

the monthly charges to consumers that are associated with the introduction of new technology.”³¹

At a time when the incumbent industry has successfully rolled out its own new technology, the Commission should examine what additional purpose, if any, a subsidy might serve, aside from an anti-competitive one. The cable industry is currently purchasing an average of 135,000 proprietary digital boxes per week for its customers.³² As a result of this enormous rate of penetration, the current methods of equipment averaging and the ability to use service revenues to create a subsidy would now appear to be unnecessary while having the unintended consequence of saddling current (non-basic tier) analog customers with the undue cost of subsidizing their upper-tier digital subscriber-neighbors.³³

The cable industry continues to practice what is effectively predatory pricing – pricing the digital box so far below cost that new competitive entrants are unable to enter and compete for a share of the equipment market. While Congress implemented an equipment averaging provision, concern over precisely this type of activity was paramount when the Commission implemented both the equipment averaging and the navigation device rules.

When the equipment averaging provision was initially implemented in 1993, pursuant to the 1992 Cable Act, the Commission discussed cable offerings of equipment at prices below cost.³⁴ The Commission recognized that Congress intended that “charges for equipment and

³¹ NCTA Response at 27, citing H.R. Rep. 104-204 at 107 (1995)(emphasis added).

³² *The Strongest Link: The Media World Comes to Cable*, Panel Discussion of Cable Industry Chief Executive Officers, NCTA Convention 2001, June 11, 2001, 9:15-10:45 am; *Time Warner Cable Readies for Large Scale VOD?SVOD Rollouts, Commits to Purchase 625,000 Scientific-Atlanta Explorer Digital Set-Tops*, <http://www.xdsl.com/newsreleases/view.asp?newsid=167557> (October 18, 2001).

³³ There is ample evidence that analog customers subsidize the digital box subscribers. In Alexandria, Virginia for example each upper-tier, analog subscriber pays the same amount per month for their box as a digital subscriber pays for their digital box, even though the replacement value of their boxes to the cable company vary from \$300 for the analog box to \$800 for the digital box. See attached cable equipment rate information for Alexandria.

³⁴ The NCTA acknowledges in its response that the 1992 provisions represent the basis for the 1996 equipment averaging provision which was expanded to permit the combined averaging of analog and digital equipment. NCTA Response at 28.

installation be based on actual cost.”³⁵ In recognizing the interest of cable companies in offering promotions, the Commission addressed its concerns with “below cost” prices head-on. The statute, according to the Commission, did not “envision that all equipment and installations can be offered at a below cost basis... Therefore, instead of allowing cable operators unlimited discretion to price all equipment and installation below cost, we will additionally require that below cost offerings be reasonable in scope in relation to the operator’s overall offerings.”³⁶

Indeed, the Commission’s current regulations regarding promotions prohibit the cable industry from making offers below cost “by increasing charges for other Equipment Basket elements.”³⁷ The cable industry’s ability to charge rates which are so far below cost for its digital boxes is counter to Congress’ and the Commission’s intent to avoid widespread below-cost offerings.

Concern over competitive pricing was again raised by the Commission in its implementation of the navigation device provision, “[w]e think it is important that pro-competitive pricing, similar to that of the cellular telephone industry and the DBS industry, evolves in the navigation equipment market.”³⁸ In discussing the use of subsidies from service charges, the Commission continued, that where an entrenched incumbent exists, “competitors to the regulated providers holding substantial market power could be disadvantaged” by the use of subsidies.³⁹ This is precisely the predicament confronting consumer electronics retailers. In order to address these concerns, CERC proposes two solutions. The first would prohibit the

³⁵ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 92-266 (Rel. May 3, 1993)(“Rate Order” and “Further Notice”) ¶294.

³⁶ *Id.* at ¶ 301.

³⁷ 47 CFR sec. 76.923(j).

³⁸ Navigation Device Order, ¶87.

³⁹ *Id.* at ¶¶87-88.

cable industry from using service revenues for subsidy purposes; the second would require the cable companies that decide to subsidize digital set top boxes to distribute those subsidies to all digital subscribers, not just those who lease equipment from the MSO.

B. As Previously Proposed by CERC, the Commission Should Prohibit the Use of Service Revenues for Subsidy Purposes.

CERC continues to urge that a cable company be prohibited from subsidizing the cost of digital set top boxes with service revenues unless that company faces effective competition in both the service and equipment markets. This proposal not only is consistent with the intent of Congress in enacting a subsidy restriction in Section 629, but also represents a method by which to limit the cable companies' subsidy capabilities to those provided by the equipment averaging provisions. The 1996 Act explicitly prohibits cable companies from subsidizing their equipment using revenue from service charges. As CERC has argued previously, it is unfortunate that when implementing the navigation device provision, the Commission chose to apply the prohibition only to cable companies not facing effective competition in the service market.⁴⁰ The result of the Commission's current analysis is that cable companies are able to underprice retail competitors by using certain unregulated service revenues to subsidize the cost of digital set top boxes.⁴¹ Such cable industry activity directly conflicts with explicit congressional intent when enacting the navigation device provision. "The Conferees intend that the Commission avoid taking actions which could have the effect of freezing or chilling the development of new technologies and services. One purpose of this section is to help ensure that Consumers are not

⁴⁰ CERC Comments at 32-36 (Nov. 15, 2000).

⁴¹ Such activity of course presents the additional temptation for the cable industry to raise its upper-tier service prices to aid the subsidy – exactly the type of activity Congress sought to avoid when enacting its provisions on equipment averaging. H.R. Rep. No. 104-204 at 112-113.

forced to purchase or lease a specific, proprietary converter box...or other equipment from the cable system or network operator.”⁴²

CERC continues to urge the Commission to rethink this analysis. In doing so, the Commission will find precisely the anti-competitive pricing behavior it raised as a concern.⁴³ In implementing this section, CERC proposes that the Commission base its analysis, as the section 304 sunset provision indicates, on the existence of effective competition in the service and equipment markets.

C. CERC Urges the Commission to Require MSOs to Distribute Any Digital Set Top Box Subsidy to All Digital Subscribers on a Nondiscriminatory Basis.

In April, 2001, CERC members proposed that the Commission amend the provisions on equipment averaging to ensure that the subsidies created are equitably applied to all cable subscribers, regardless of whether they lease a box from the cable company or obtain their own box at retail.⁴⁴ This proposal is not, as the NCTA claims, a “contortion” of the equipment averaging provision.⁴⁵ Rather, the proposal represents a pro-consumer, pro-competitive method for ending the discriminatory practices developed by the MSOs under the equipment averaging provision. CERC’s proposal would end the existing unintended conflict between the equipment averaging provision and the navigation device provision.⁴⁶ The NCTA indicates in its September 21st response that CERC’s proposal to equalize the subsidy would create new regulatory burdens. Yet, the NCTA, in its October 10, 2001 letter to the Commission, proposes a “buy back” method

⁴² H.R. Rep. No. 104-458 at 181.

⁴³ see discussion at page 16-18 above.

⁴⁴ See RS/CC Letter to Powell.

⁴⁵ NCTA at 28.

⁴⁶ The NCTA suggests in its Response that Congress did not share CERC’s concern over the conflict between the equipment averaging provision and the navigation device provision. The conflict is not inherent in the sections themselves but is a product of the way the cable industry has chosen to implement equipment averaging. CERC’s proposal gives full effect to both provisions which the Commission is required to do in interpreting and applying the Act.

that is not only significantly more burdensome, but that lays the burden specifically on the consumer. The description of the CERC proposal set forth below confirms the consumer benefits that would flow from its adoption. It also demonstrates that any adjustments needed to the cable industry's accounting methods and other business practices that are required to effectuate its own "buy back" proposal are more complex and more burdensome than any changes that would be required under the CERC proposal.

As presented in RadioShack and Circuit City's letter to Chairman Powell on April 16, 2001, CERC's proposal would mandate that the cable industry provide to their customers who obtain navigation devices at retail the same subsidy that they extend to their customers who lease cable industry converter boxes.⁴⁷ More specifically, the proposal would amend the equipment averaging regulations to:

- Require that cable companies notify their current subscribers of their ability to purchase or lease navigation devices from unaffiliated vendors;
- Require that cable companies provide notification to new subscribers that they may already own equipment to receive cable services without the need for additional equipment from the cable company and that the subscriber may purchase or lease navigation devices from unaffiliated vendors without the need for additional equipment from the cable company;
- Require that, if a cable company chooses to use the Commission's equipment averaging provision, it must disclose to subscribers the amount of any subsidy reflected in the price of a digital navigation device; and
- Require a cable company choosing to aggregate equipment to provide to all of its digital subscribers the same subsidy, regardless of whether they choose to lease or buy a navigation device from an unaffiliated vendor or lease or purchase through their cable company.

In its September response, the NCTA suggests there would be an administrative burden associated with "extending the equipment averaging process to retail customers."⁴⁸ However, the purpose of CERC's proposal is not to "extend" the subsidy to retail customers, but to provide

⁴⁷ See RS/CC letter to Powell at 2.

⁴⁸ NCTA Response at 31.

the same subsidy to all cable subscribers, without discriminating based on their choice of equipment. The NCTA confuses the matter by referring the subsidy as a “retail subsidy” and by suggesting that leasing from a cable company is somehow distinguishable from purchasing in a store with regard to the distribution of the subsidy. The NCTA also claims that CERC proposes an up-front subsidy payment. Neither contention is correct. The subsidy for digital set tops is delivered to digital subscribers today by effectively crediting on each leased-box subscriber’s monthly bill the difference between the actual monthly cost of the digital box and the amount charged by the MSO. CERC’s proposal requires only that this credit, which is already embedded in the subscriber’s cable bill, be made an explicit line entry on the bill of every digital cable customer who obtains a digital box from another source.⁴⁹ There is no up-front payment involved. This proposal is far simpler and easier to administer than the NCTA buy-back proposal and, unlike the NCTA’s proposal, would enable the development of a competitive market for navigation devices as required by the Act.

As CERC indicated in its July Status Report, CERC’s proposal removes retailers from the subsidy calculation and distribution mechanism altogether.⁵⁰ CERC proposes that cable companies that choose to aggregate their equipment costs identify the amount of the subsidy already provided to digital cable subscribers through a reduction in the charge for the set-top box on their monthly cable bills. Digital subscribers who choose to purchase a navigation device at retail would receive the subsidy in the form of a credit on their monthly bills. In the event a cable subscriber moves out of the franchise area, the subsidy credit by the old cable company would end. The new cable company would provide any subsidy paid to its own digital

⁴⁹ Alternately, the subsidy amount could be shown on the bill of every digital subscriber along with a cost based lease rate for those who lease the box from the cable company.

⁵⁰ CERC Report at 15.

subscribers to the new subscriber upon evidence of equipment-ownership. This proposal would achieve the NCTA goal of moving much of the capital cost of digital boxes off the cable company's books, it would avoid the need for the equipment handling procedures associated with the buy back and, most importantly, would avoid the detrimental anticompetitive effects of the NCTA proposal.

The calculation required to ascertain the amount of the subsidy currently provided to digital subscribers can be performed on the existing FCC form (1205) used by the cable industry to compute cable box and remote control costs. Cable operators already maintain records of the cost of the equipment they lease to subscribers. They enter these amounts in the spaces provided on FCC Form 1205, Schedule C. Today, under the aggregation rules, the capital cost of digital and analog boxes may be combined before being entered on the form.⁵¹ Nonetheless, Form 1205 provides multiple columns for entry of converter box costs. If the costs of digital and analog boxes were simply entered in separate columns, then the form could be used directly to compute the cost of digital and analog boxes separately. Comparison of these costs with the monthly charges – also reported on Form 1205 – would show the amount of the subsidy. This amount would be entered as a credit on the subscriber's bill.

⁵¹ See FCC Form 1205, Instructions for Determining the Costs of Regulated Cable Equipment and Installation, p.12.

Conclusion.

CERC urges the Commission, five years after Congress passed legislation, and one year after its first deadline for compliance, to adopt the amendments to its regulations discussed herein. CERC and its members pledge to work with the Commission to resolve any outstanding issues that may stand in the way of real consumer choice with respect to navigation devices.

Respectfully submitted,

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I, Janet Davis, hereby certify that true copies of the foregoing Consumer Electronics Retailers Coalition Reply to the NCTA Response to CERC Status Report was served by FedEx or ECFS on November 6, 2001, to the persons listed below.

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APPENDIX

From CableLabs Web Site (www.OpenCable.com/OCAP.html):

OpenCable Applications Platform (OCAP)

What is OCAP?

The OpenCable Applications Platform specification is a so-called middleware software layer. OCAP is intended to enable the developers of interactive television services and applications to design such products so that they will run successfully on any cable television system in North America, independent of set-top or television receiver hardware or operating system software choices.

What does OCAP do?

OCAP enables manufacturers and retail distributors of set-tops, television receivers or other devices to build and sell attractive and capable devices to consumers that will support all services delivered by cable operators to devices currently available to consumers via lease from cable operators.

This specification will be a requirement for retail devices intended to connect to cable. Cable operators may support equivalent services using boxes they specify and purchase and then lease to consumers. OCAP will not be a requirement for those devices, although some MSOs may choose to incorporate OCAP even in leased set-top boxes.

This spec is not a requirement of FCC rules implementing portions of the 1996 Telecommunications Act. However, it does further the Commission's goal of increasing consumer choice of equipment.

Where is the OCAP spec?

The first Working Draft of the OCAP spec was released in January 2001, and followed the well-established CableLabs procedure by which common cable industry technology platforms have been developed for many years now.

Vendors who signed the OpenCable Non-Disclosure Agreement were then invited to submit detailed comments and critiques of the draft. The authoring team, which includes software developers and cable industry representatives, then reviewed and reconciled the comments.

The spec is set for release as an Interim Specification in June 2001, and will be available to the general public. The spec may then be forwarded to standards development organizations.

Release of the draft specification early in 2001 allowed middleware developers and equipment manufacturers to begin building products to the spec. CableLabs is now supporting interoperability events wherein CableLabs' state of the art digital cable headends and facilities are made available to assist product development. This process serves to validate the written specification, identify areas that need to be amended based on real world implementation, generally reduce the time to market for such product, and improves the expected performance and reliability of such products.

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